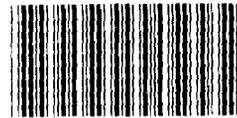


GAO

January 1986

# SPARE PARTS PRICING

## Inappropriate Use of Rate Agreements



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United States  
General Accounting Office  
Washington, D.C. 20548

National Security and International  
Affairs Division

B-219927

January 13, 1986

The Honorable Caspar W. Weinberger  
The Secretary of Defense

Dear Mr. Secretary:

As requested by the Chairman, Senate Committee on Governmental Affairs, we are reviewing spare parts pricing at selected locations<sup>1</sup>. Our primary objective in this review is to determine if the spare parts initiatives you established are being followed. As part of our review, we found buyers and contracting officers at the San Antonio Air Logistics Center (SA-ALC) were using the existence of rate agreements as justifications for accepting proposed prices without performing adequate price analyses. Although we will include this information in our report to the Chairman, we are bringing it to your attention at this time so you can take appropriate action.

During our review, we identified 21 procurements, or 13.6 percent, of a random sample of 155 procurements where buyers relied on the existence of a rate agreement to justify accepting proposed prices without a price analysis as required by the Department of Defense procurement regulations. A statement was included in each contract file stating that a rate agreement supported the price paid. We do not, therefore, believe the buyers and contracting officers took adequate action to assure reasonable prices.

Rate agreements between contractors and buyers exist at the other locations included in our review. We have not, however, done the work at those locations to determine if buyers are using the rate agreements in the same manner as were the buyers at SA-ALC. We believe that you may wish to determine the extent to which this practice exists at other buying activities and take necessary corrective action.

We selected four procurements from the 21 sampled contracts for further review and found two were overpriced and one was being locally manufactured for significantly less. We did not review the remaining 17 procurements because of the time required to analyze these procurements and the fact that this issue was ancillary to our overall review objectives.

<sup>1</sup>The selected locations are: Army's Aviation Systems Command, Navy's Aviation Supply Office, Navy's Ships Parts Control Center, Air Force's San Antonio Air Logistics Center, and Defense Electronics Supply Center.

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## What Are Rate Agreements?

At the SA-ALC, spare parts are frequently purchased under rate agreements that have been negotiated with major contractors. Major contractor plants frequently have a resident administrative contracting officer (ACO). This official, in some cases, negotiates a rate agreement with the contractor for direct labor hours, overhead, and profit that can subsequently be used by the contractor when preparing price proposals for government contracts. It is a convenient and effective method to avoid the necessity of negotiating rates on every procurement. These agreements are frequently called spare parts formula pricing agreements or memoranda of agreement.

The Armed Services Procurement Manual states that it is important for procurement officials to know that a formula pricing agreement or memorandum of agreement exists when pricing spare parts because it describes a contractor's pricing policy and practices. The manual also states that, by itself, knowledge of how a company prices spare parts and how the ACO reviews the agreement does not guarantee the reasonableness of prices.

For example, on April 15, 1985, the principal ACO at a major contractor forwarded updated, negotiated rates to the buying offices at the SA-ALC and the Warner Robins Air Logistics Center. The rates were pertinent to an ongoing spares pricing agreement. In a cover letter, the ACO stated a concern that some government users were looking at the agreement on rates as an automatic determinant of price reasonableness. The ACO pointed out that it is not an automatic determinant of price reasonableness and that it does not necessarily predict exact costs to produce a part nor present a reasonable value for the part.

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## Reliance on Rate Agreements Lead to Overpriced Spare Parts

Two of the four procurements we selected for more detailed review were overpriced and one was manufactured locally for significantly less. In each case, the buyer relied on the rate agreement to determine whether proposed prices were fair and reasonable. We also found that three of the procurements should not have been made. Details follow.

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## Link Assembly

The buyer relied on a rate agreement and accepted a proposed price of \$16,400 for a left side link assembly that is part of an engine mount. A price analysis shows the item should cost less than \$4,000. Further, there is a right hand link assembly and the two assemblies are very much like right and left shoes. The Air Force has been paying \$16,400 for the left side assembly and less than \$5,000 for the right, although

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the items are almost identical. Because of our work on this item, the Air Force went back to the contractor concerning the item's price. The contractor has agreed to voluntarily refund about \$82,000 for the last two purchases of seven link assemblies (the refund amounts to about \$11,700 per unit).

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### Pan Toilet

One of the items purchased is a pan toilet for an aircraft latrine. The proposed and accepted price for each of these pans was \$317.97. The only evidence of price analysis was a statement that a rate agreement existed. We physically inspected the item and found it was made from thin fiberglass and weighed about 1 pound.

Based on the inspection and the fact that SA-ALC paid \$317.79 for each unit without price analysis, we requested the SA-ALC technical personnel to provide us with a price estimate. The estimate provided was \$97.74 each to purchase a quantity of 18 pans. These personnel also stated that they had recommended action be taken to obtain a voluntary refund. Based on the price estimate, the refund should total about \$20,000 for pan toilets purchased over the last several years.

In December 1983, an engineer reported in writing that the pan was poorly designed and a technician wrote that there were no known technical reasons to support recent price increases. They recommended no additional new procurements because the pan would be replaced by a new latrine in 1985 and the old pans should be repaired until then. According to the System Production Manager, the entire latrine system is being redesigned in a manner that would eliminate this item. Nevertheless, 67 more pans were purchased on two separate occasions after this.

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### Pan Assembly

The pan assembly is used in the same aircraft latrine as the pan toilet. The assembly covers the portion of the floor not covered by the pan toilet. The current proposed and accepted price for the assembly was \$239.79. The acceptance was based on the existence of a rate agreement. The only evidence of a price analysis being performed was a statement that such an agreement existed.

We did not ask for a value analysis on the pan assembly, but we learned that it has been manufactured in the SA-ALC's plastics shop at a cost of about \$160 each since September 1984. Since that time, 79 pans have

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been purchased at prices ranging from \$239.79 to \$272.22 each. According to the System Production Manager for this item, some of these pans will probably be disposed of because a new pan assembly will replace both the pan toilet and pan assembly. This indicates that it may have been unnecessary to procure some of these pans. We also believe that the cost of \$160 to locally manufacture this item provides a basis for questioning the acceptability of prices ranging between \$239.79 to \$272.22.

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### Panel Assembly

The panel assemblies are made of fiberglass and go beneath the wing of an aircraft. The SA-ALC purchased two of the panels at a unit price of \$2,540 for a total of \$5,080.

We found two panels had been in a SA-ALC warehouse since 1973. The item manager was not aware that the panels had been in the warehouse for over 10 years. After we informed the item manager about the on hand stock, the item manager attempted to cancel the new procurement but was unsuccessful because the order was too near delivery. Further, maintenance personnel stated that the new procurement is unnecessary because the item can be easily repaired during maintenance.

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### Conclusions

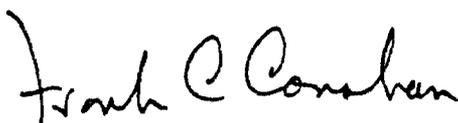
In view of our findings at the SA-ALC, we believe you may wish to determine whether similar conditions exist at other locations. If similar conditions are found, you may want to consider requiring post reviews of recent prices paid for spare parts where their acceptance was justified by the existence of rate agreements rather than by the buyer performing adequate analysis to establish price reasonableness. This would permit a determination of whether refunds or other corrective actions are appropriate.

SA-ALC procurement officials immediately took corrective action after we had told them of the situation. They have informed buyers and contracting officers of the need for adequate price analysis in conjunction with rate agreements.

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A copy of this report is being sent to the Chairman, Senate Committee on Governmental Affairs. Copies are also being sent to the Chairmen, Senate and House Committees on Armed Services and Appropriations. Copies will also be provided to interested parties. We would appreciate being advised of any actions taken on this matter.

Sincerely yours,



Frank C. Conahan  
Director



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